Fair Political Practices Commission

Memorandum

To: Chairman Randolph, Commissioners Blair, Downey, Karlan, and Knox

From: John W. Wallace, Assistant General Counsel
Luisa Menchaca, General Counsel

Subject: Proposal to Merge Government Code section 1090, et seq., and Public Contracts Code sections 10410 and 10411 into the Political Reform Act

Date: September 24, 2004

A. Executive Summary

The purpose of this staff memorandum is to update the Commission regarding the proposal to merge other conflict-of-interest provisions not currently in the Political Reform Act (the "Act" or "PRA"),[1] into the Act. This proposal was first presented to the Commission in July 2003. As we noted in July, there are a variety of conflict-of-interest laws that appear to overlap with the Act. This creates confusion, both about application of the law and the responsibility for interpretation of these rules by regulation or by advice letter.

Since the July 2003 Commission meeting, staff has conducted several interested persons' meetings on specific issues relating to the possible merger of the conflict-of-interest laws (January 2004, regarding the project generally, April 2004 regarding section 1090, June 2004 regarding the Public Contract Code and other conflict-of-interest laws, August 2004 regarding enforcement issues). At the January meeting, significant differences of opinion were evidenced by testimony from the supporters of the project and the California District Attorneys Association (CDAA).

Representatives of the CDAA expressed opposition to the merger and voiced concerns about losing jurisdiction over felony criminal enforcement and concerns about Commission advice making enforcement of the law more difficult. The CDAA noted that any advice, even informal advice, or advice based on erroneous facts, could hinder enforcement.

1090 Pilot Project

In an effort to discover an approach that would alleviate the concerns of the CDAA and move the project forward, staff met with representatives of the Attorney General's office, the League of Cities, and a representative of the CDAA. After the meetings, staff believes that the approach most likely to gain support from interested parties is a pilot project created legislatively

[1] Government Code sections 81000 - 91014. Commission regulations appear at Title 2, sections 18109-18997, of the California Code of Regulations. All future references are to the Government Code unless otherwise specified.

with the Commission as a sponsor. The 1090 Pilot Project would have the following characteristics:

1. Section 1090 will not be moved or amended at this time.

2. The pilot project will run for a 2-3 year period beginning January 1, 2006.

3. The FPPC will provide written opinions on the application of 1090, subject to the following parameters:

   - The FPPC will forward a copy of the opinion request to the Attorney General's office, the local district attorney and local agency legal counsel prior to proceeding with a draft opinion;

   - The response will follow the existing Commission opinion process as set forth in Commission regulations (or a variation thereof) including circulation of a draft opinion for review by the Attorney General's office, the local district attorney and the public;

   - The opinion, when final, will provide no immunity. The CDAA has also suggested that the legislation should include a provision which, in some form, will limit the admissibility of the opinion in a subsequent criminal prosecution, adjust the burden of proof relative to the effect of the opinion; or both, or in some other manner eliminate the potential problem created by the opinion on the prosecution of a bad actor.

   - The Commission will be given sufficient additional funding to deal with the increased workload (including the educational component). Funding will further be increased should the pilot project become permanent and the scope of the project increased.

Public Contracts Code

Additionally, staff asks the Commission to approve staff's proposal to start drafting legislation to relocate Public Contracts Code sections 10410-10411 into the Act this legislative session, with conforming clarifying changes. Section 10410 prohibits officers or employees in state civil service from engaging in paid employment, activities, or other enterprises (or in such activities in which the officer or employee has a financial interest) funded by a state contract. Further, no officer or employee in state civil service shall contract on his or her own individual behalf to provide services or goods as an independent contractor with any state agency.

Section 10411 prohibits retired, dismissed, separated, or former employees from entering into a contract in which he or she participated as a state employee, for two years after leaving state employment. In addition, no employee formerly in a policymaking position responsible for

a subject area may enter into a contract in that area for 12 months after retirement, dismissal, or separation.

There has been no opposition to incorporation of the Public Contract Code sections in the Act when discussed at interested persons meetings.

B. History and Background

A basic purpose of the Act (adopted by the voters of California in 1974) was to prohibit conflicts of interest caused by an official's financial interest in a governmental decision. However, the Act's conflict-of-interest law is but one of several conflict-of-interest prohibitions which currently exist in California. For example, as early as 1985, the Commission recognized the overlap between the Act and section 1090. Similar to the Act, section 1090 requires disqualification in some circumstances where a conflict of interest exists, and even provides more severe consequences than the Act in other circumstances. Section 1090 generally prohibits agencies from contracting in cases where a member of the governing body may have a financial interest in the contract. In addition to voiding a contract made in violation of its prohibition, section 1090 also provides for felony penalties.

On January 1, 1999, the Bipartisan Commission on the Political Reform Act of 1974 also acknowledged the overlap between the Act and section 1090.

> "RECOMMENDATION NO. 16 Consolidation of State Conflict Codes Under One Agency. All state conflict of interest statutes should be consolidated into a single code or body of law to be interpreted and enforced consistently by a single state agency. Findings Supporting Recommendation: Based upon the discussions and deliberations of the Commission, the Bipartisan Commission finds that the existence of multiple conflict of interest provisions sprinkled throughout various Codes creates unnecessary confusion in the minds of public officials who strive to obey the law but who often have no idea what Code to review or whom to ask for advice.
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> "For example, a public official wondering whether he or she has a conflict of interest in a particular governmental decision must individually consider the Political Reform Act, Government Code Section 1090, the conflict of interest provisions of the Public Contracts Code, and a number of other agency-specific and local conflict of interest provisions. These provisions are administered or enforced by different agencies such as the FPPC, the California Department of Justice, the courts, and numerous local agencies. The public official must determine for himself or herself what agency to approach for an answer to a conflict of interest question. For example, a question about the Political Reform Act conflict of interest rules must be addressed to the FPPC while a question about a Section 1090 contract issue must be addressed to the Department of Justice. The Bipartisan Commission therefore recommends that the Legislature

consolidate all conflicts of interest laws into one Code, presumably the Political Reform Act, to be interpreted and enforced consistently by a single authority."

Several interested parties have requested that the Commission again consider sponsoring a legislative proposal that would move some of these other laws into the Act. The amendment would give the Commission regulatory, advice and possibly enforcement authority in these areas in an effort to provide greater continuity in application of these laws and greater service to the public.[2]

C. The Political Reform Act

One of the core areas of the Act is its provisions regarding conflicts of interest.[3] The Act provides an 8-step process to determine if a conflict of interest exists. The standard eight-step process includes: (1) Public official; (2) "Making," "participating in making," or "influencing" a governmental decision?; (3) Economic interests?; (4) Are they directly or indirectly involved?; (5) Are they materially affected?; (6) Is it reasonably foreseeable?; (7) Does it effect the public generally the same way? and (8) Is participation legally required? (Regulation 18700.)

D. Government Code section 1090

One of the most well known conflict-of-interest laws outside of the Act is in section 1090 et seq.

1. Persons Covered

Virtually all board members, officers, employees and members of advisory bodies.

2. Contract Decisions

The making of the contract has been construed to include preliminary discussions, negotiations, compromises, reasoning, planning, drawing of plans and specifications and solicitation for bids, as well as decisions to modify, extend or renegotiate a contract. The term "contract" in section 1090 has been construed to apply to a developmental agreement between a city and a developer, and in one case to a hospital district's payment of travel expenses for a board member's spouse.

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[2] A search of advice letters published on Lexis revealed approximately 224 Political Reform Act advice letters that make mention of section 1090 or Public Contracts Code sections 10410 or 10411.

[3] The purposes of the conflict-of-interest provisions of the Act are set forth in section 81001 and 81002. They are:

"(b) Public officials, whether elected or appointed, should perform their duties in an impartial manner, free from bias caused by their own financial interests or the financial interests of persons who have supported them ..." [Section 81001(b).]

"(c) Assets and income of public officials which may be materially affected by their official actions should be disclosed and in appropriate circumstances the officials should be disqualified from acting in order that conflicts of interest may be avoided ...." [Section 81002(c).]

3. Participation

Section 1090 would be violated if the official had participated in any way in the making of a contract in which the official has a financial interest. Generally, it is a question of fact as to whether an official was involved in the making of the contract. If an official is a member of a board or commission which executes the contract, *the official is conclusively presumed* to have participated in the making of the contract. This is true even if the official abstains from all participation in the decision, or in one case, even where a member resigned from the council prior to its vote on the contract.

4. Presence of Requisite Financial Interest

For section 1090 to apply, the public official in question must have a "financial interest" in the contract in question. The term "financial interest" is not specifically defined in the statute and the statutory definition in section 87103 does not control application of section 1090. Historically, this concept has been broadly interpreted by the courts.

5. Temporal Relationships

An official who has contracted in his or her private capacity with the government before the official is elected or appointed does not violate the section. The official's election or appointment does not implicate 1090. As noted above, however, renegotiating a contract is considered a new contract under 1090.

6. Exceptions to the General Prohibition

The government code and case law provide a series of express exemptions and exceptions to the 1090 rule.

7. Penalties

A contract made in violation of section 1090 is void. Any payments made to the contracting party under a contract made in violation of section 1090 must be returned, and no claim for future payments under such contract may be made. In addition, the public entity is entitled to retain any benefits which it receives under the contract. (*Thomson v. Call* (1984) 38 Cal.3d. 650.)

Moreover, any person, who is found guilty of *willfully* violating any of the provisions of section 1090 et seq., is punishable by a fine of not more than $1,000 or imprisonment in state prison. (Section 1097.) For an official to act "willfully," his or her actions concerning the contract must be purposeful and with knowledge of his or her financial interest in the contract. (*People* v. *Honig* (1996) 48 Cal.App.4th 289, 334-339.) Additionally, such an individual is barred from holding any public office in this state. (Section 1097.)

Since the July 2003 Commission meeting, staff has conducted several interested persons' meetings on specific issues relating to the possible merger of the conflict-of-interest laws (January 2004, regarding the project generally; April 2004 regarding section 1090; June 2004 regarding the Public Contract Code and other conflict-of-interest laws; August 2004 regarding

enforcement issues). At the January meeting, significant differences of opinion were evidenced by testimony from the supporters of the project and the California District Attorneys Association (CDAA).

Representatives of the CDAA expressed opposition to the merger and voiced concerns about losing jurisdiction over felony criminal enforcement and concerns about Commission advice making enforcement of the law more difficult. The CDAA noted that any advice, even informal advice, or advice based on erroneous facts, could negatively impact a criminal prosecution.

In an effort to discover an approach that would alleviate the concerns of the CDAA and move the project forward, staff met with representatives of the Attorney General's office, the League of Cities, and a representative of the CDAA. After the meetings, staff believes that the approach most likely to gain support from all interested parties is a pilot project. A pilot project may demonstrate to the CDAA that the Commission's jurisdiction over section 1090 will benefit the regulated public, while at the same time enhancing compliance and enforcement. Please note however, that none of these groups has of yet endorsed any specific approach, including the pilot project approach described herein.

1090 Pilot Project Decision Points

1. Should Commission Staff Pursue Legislation Establishing a Pilot Project Granting the Commission Jurisdiction for Limited Purposes Over Section 1090?

OPTION A. The Commission may bypass a pilot project and move forward with legislation incorporating section 1090 into the Act, with or without clarifying changes.

OPTION B. The Commission may move forward with a more limited pilot project with the limitations discussed below.

OPTION C. The Commission may choose to discontinue the 1090 project in its entirety.

Staff Recommendation: Many of the concerns expressed by the CDAA are regarding the potential negative effect of Commission advice on enforcement of section 1090.

The advantage of the pilot project is that it will demonstrate to the CDAA that no adverse effects will result by giving the Commission jurisdiction over section 1090. This conclusion can be tested during the pilot project, prior to any legislative changes to section 1090 itself. At the end of the pilot project, the Commission will be able to either proceed with incorporation of the statutes into the Act, may amend and incorporate the statutes into the Act, or may abandon the project.

The disadvantage of the pilot project is that it will to some extent provide a distorted view of the effect of incorporation of the statutes, since the pilot project will be limited, both in duration and scope.

However, staff believes that a pilot project would be a responsible logical first step toward incorporation section 1090 into the Act. Staff recommends Option B. If the Commission agrees, the following additional decision points are presented:

2. What Should Be the Duration of the Pilot Project?

In order to have an adequate opportunity to build up a track record with respect to application of section 1090, staff believes a 2-3 year period may be necessary. ***Therefore, staff recommends a 3 year pilot period.***

3. What Form Should the Advice on 1090 Take?

As you are aware, the Commission has a variety of methods which provide education and outreach to the regulated public. Commission staff may provide oral advice or informal written advice -- neither of which provide immunity. In the alternative, staff may provide formal written advice which does provide immunity. Finally, the Commission may take formal action by either adopting a Commission opinion or Commission regulations, or even legislation.

Staff believes that the pilot project should involve some Commission role in decisions regarding application of section 1090. This may be before the fact, by utilizing the Commission opinion framework, or after the fact in having staff advice letters ratified by the Commission prior to being issued.

The advantage of using the opinion process is that it is already fully developed and allows for significant public access. The disadvantage is that if the process is too cumbersome, officials may be deterred from requesting the advice.

Staff recommends using the existing Commission opinion process.

4. To What Extent Should the Interested Public be Involved, Prior to the Issuance of an Opinion?

During a pilot period, involvement of interested parties, such as the Attorney General's office, the local district attorney and local agency legal counsel would be very important and very helpful in evaluating the effectiveness of the program. If the pilot project uses the existing Commission opinion process as set forth in Commission regulations (or something similar), this will include the circulation of a draft opinion for review by the Attorney General's office, the local district attorney and the public before it is adopted by the Commission.

Staff recommends using the existing Commission opinion process.

5. What will be the Legal Effect of the Opinion?

Ultimately, the goal of incorporating 1090 into the Act will be to provide public officials guidance and immunity in some instances. By providing informal and formal advice, staff believes that compliance with the law will be significantly enhanced. Currently, reliance on formal written advice from the Fair Political Practices Commission confers immunity from prosecution by the Commission on the requestor and is evidence of good faith in any other civil or criminal proceeding. (Section 83114(b).)

However, the CDAA has strong concerns about the immunizing effect of the opinion, as well as the evidentiary effect of such an opinion. Thus, during the pilot period, it may be prudent to limit the effect of 1090 opinions. The Commission can choose to decide that the opinion, when final, will provide no immunity. Moreover, the CDAA has recommended that the legislation may include a provision which, in some form, will limit the admissibility of the opinion in a subsequent criminal prosecution, adjust the burden of proof relative to the effect of the opinion; or both. The Commission may also choose to apply a limited-effect rule on a case-by-case basis, treating some opinions as informal and others as formal, or by placing other caveats on the advice (such as allowing use of the letter as evidence of good faith conditioned on the provision of all material facts).

6. What Will be the Funding Impacts of Such a Program? Should Additional Funding for the Program be Requested?

The Commission will need additional funding to deal with the increased workload that will accompany the pilot project. Funding will further be increased should the pilot project become permanent. Staff would propose that the funding request be incorporated into the bill.

Overall Recommendation: Staff requests the Commission's approval to pursue the pilot project legislatively.

E. Public Contracts Code

There are a variety of other conflict-of-interest laws that raise similar issues. Staff has proposed several laws (common law and statutory) for possible incorporation into the Act. After numerous interested persons meetings, the only law that seemed to present the fewest difficulties in incorporating it into the Act is Public Contracts Code section 10410 and 10411. Public Contracts Code section 10410 provides:

> "No officer or employee in the state civil service or other appointed state official shall engage in any employment, activity, or enterprise from which the officer or employee receives compensation or in which the officer or employee has a financial interest and which is sponsored or funded, or sponsored and funded, by any state agency or department through or by a state contract unless the employment, activity, or enterprise is required as a condition of the officer's or employee's regular state employment. No officer or employee in the state civil

service shall contract on his or her own individual behalf as an independent contractor with any state agency to provide services or goods.

Section 10411 provides:

"(a) No retired, dismissed, separated, or formerly employed person of any state agency or department employed under the state civil service or otherwise appointed to serve in state government may enter into a contract in which he or she engaged in any of the negotiations, transactions, planning, arrangements, or any part of the decision-making process relevant to the contract while employed in any capacity by any state agency or department. The prohibition of this subdivision shall apply to a person only during the two-year period beginning on the date the person left state employment.

"(b) For a period of 12 months following the date of his or her retirement, dismissal, or separation from state service, no person employed under state civil service or otherwise appointed to serve in state government may enter into a contract with any state agency, if he or she was employed by that state agency in a policymaking position in the same general subject area as the proposed contract within the 12-month period prior to his or her retirement, dismissal, or separation. The prohibition of this subdivision shall not apply to a contract requiring the person's services as an expert witness in a civil case or to a contract for the continuation of an attorney's services on a matter he or she was involved with prior to leaving state service."

The two provisions have infrequently been interpreted by the courts or the Attorney General's office. Thus, the sections for the most part do not present the interpretation problems that section 1090 has. In addition, the structure of the statutes is very similar to statutes that already exist in the Act. Finally, the scope of the two statutes is limited to state employees. Thus, we believe there would be a significant public benefit to incorporating these two sections into the Act with conforming changes. This would allow the Commission to enforce and advise on the sections, and would allow further regulatory clarification where needed.

However, further work would be necessary regarding the following:

(1) Funding. How much additional funding will be required for the Commission to accept the challenge of moving these sections into the Act?

(2) Penalties: Currently, violation of these sections may result in the contract being void, as well as civil and criminal penalties. Determining how these penalty provisions will be melded into the Act will need additional work.

Recommendation: Staff asks for the Commission's consent to proceed with the development of a legislative proposal (in cooperation with interested parties) that would import

these sections into the Act, clarifying and conforming the sections to the other statutes in the Act. This could be completed this legislative session.